Setting up your Business in Hungary
Issues to consider

KRESTON INTERNATIONAL

In Hungary a high priority of the economic policy is to make further efforts to develop the economy as an integrated part of the European market. Hungary now provides for foreign investors a relatively stable legal framework and very competitive, mostly European Union harmonized tax system. The government has a strong commitment to easing business processes and to increasing the competitiveness of both SMEs and large enterprises in Hungary based on the wide range of available incentives.

However there are a number of issues which you must consider when you are looking to set up your business in Hungary. This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

Establishment (a branch of your overseas business)

- Not a separate legal entity but an extension of the overseas parent company;
- No limited liability or ring-fencing of the Hungarian operations;
- If have a permanent establishment in Hungary then profits from this PE are liable to Hungarian Corporation tax;
- Must file **audited branch accounts**, prepared under Hungarian GAAP, at Court of Registration for public inspection. Branches with parent companies established in EU are not obliged for audit and to file the Branch's accounts, but the **parent company accounts translated into Hungarian** language must be filed, even if these are not disclosed overseas.

Limited Liability Company

- Members (partners) have limited liability up to share capital (minimum of HUF 3m);
- Gives a perception of a local business, with longevity;
- Corporation tax to be paid on company profit;
- Has to disclose annual report according to Hungarian GAAP at Court of Registration for public view;
- Accounts require auditing if turnover exceed HUF 300m p.a. or number of employees exceed 50 in average of last two business years.

Company limited by shares

- Members (partners) have limited liability;
- Can be a private limited company or a public limited company;
- Public limited company is registered at a stock exchange or the trade with their shares is public;
- Corporation tax to be paid on company profit;
- Corporation tax to be paid on company profit;
- Has to disclose annual report according to Hungarian GAAP at Court of Registration for public view;
- Accounts require auditing if turnover exceed HUF 300m p.a. or number of employees exceed 50 in average of last two business years.

How much Corporation Tax will the business pay?

Current Corporation Tax rate in Hungary is:

Tax rate		Taxable profit (HUF)
Flat rate	9%	no limit

If a Hungarian Business incurs a loss then it can only be carried forward and offset against future profits from the same trade. It cannot be offset against parent company's profits. The loss can be carried forward for five years time. But only 50% of the future tax base can be offset against the losses in a tax year.

What if we use Hungary to set up our holding company?

Hungary's tax legislation means that it is a very attractive place to set up a holding company.

Dividends and liquidation proceeds received by Hungarian companies are exempt from corporation tax. There is no withholding tax on profit distributions paid to persons other than individuals. The withholding tax exemption does not depend on the corporate shareholder's location, size of its holding and the time the shares are held.

The capital gains realized by the Hungarian entity on the sale of shares are exempt under following conditions. Such exemption is conditional upon the Hungarian company holding at least 30% interest in the subsidiary, and on the reporting of the acquisition of the shares to the tax authority within 60 days from the purchase or incorporation. If such conditions are met, then the exemption is applicable after a one-year holding period. But in this case any loss suffered upon the resale will become non-tax-deductible.

All of which makes Hungary a very advantageous location to set up a holding company.

What if we make cross-border transactions between group companies?

Hungary follows internationally recognized **Transfer Pricing** (TP) rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm's length basis. The price and terms should be the same as if the transactions had been concluded between completely independent parties.

Typical transactions between affiliated entities that are covered by TP regulations are:

- Sale and purchase of goods;
- Wagework;
- Provision of management services;
- Property rental charges;
- Transfer of intangible assets e.g. trademarks, patents, etc.;
- Sharing of knowledge, expertise, business contacts etc.;
- Provision of financial support e.g. inter-group loans and charging a "market" interest on loans.

A business will need to prepare a Transfer Pricing Report proving the arm's length basis of transactions. The report will include a functional and risk analysis, analysis of the adopted pricing model and benchmarking of the arm's length basis.

Small enterprises are exempt from Hungary's TP reporting regime, so only "medium" and "large" entities need to undertake detailed TP analysis. A "medium or large entity" for TP purposes is one with 50+ employees, or Revenues €10m+, or Gross Assets €10m+. However, these figures shall be calculated on group level.

However, even if an entity is exempt from the Hungarian transfer pricing regime it may fall under the scrutiny of the other international tax jurisdictions where it transacts. There may also be other tax regulations which ensure transactions are undertaken at a commercial value.

What Employment Taxes and Social Security will need to be paid?

If an individual is resident in Hungary then they are subject to Hungarian tax laws. An individual is regarded as tax resident if he or she has (i) Hungarian citizenship, (ii) permanent home in Hungary or if (iii) he or she habitually resides in Hungary. A (iv) person who stays in Hungary for more than 183 days in a calendar year is regarded as habitually resident there, if a double taxation agreement exists between Hungary and the other country.

Persons resident in Hungary are liable to pay personal income tax on their *worldwide* income. Non-residents are subject to personal income tax only upon their income from Hungarian sources.

We would advise any new entrant to Hungary or person who spends time working in Hungary to take professional advice to determine whether they are Hungarian tax resident.

Current Personal Income Tax rates in Hungary are:

Band of income (HUF)	**Tax rate (%)**
single band	15

Employers and employees also have to pay Hungarian social security, which is called National Insurance (TB):

Current Social Security rates are:

	Band of income (HUF)	**Rate (%)**
Employer	single band	23,5
Employee	single band	18,5

It is the employers' legal responsibility to pay over employee's tax and social security deductions to the Hungarian tax authorities.

Hungary has a Reciprocal Agreement with Australia, Canada, Korea, EU countries and some others whereby when an overseas national of those countries is seconded to Hungary for a defined period of time and continues to pay social security in their home country, then the employer and employee are exempt from paying Hungarian social security.

What is Value Added Tax (VAT) and should the business be registered?

VAT is a "goods and services tax" on supplies made, the standard rate of which is 27%. If a business makes taxable supplies in excess of HUF 8m in any calendar year then it MUST be registered for VAT.

There are four basic types of supply

- Taxable – must charge VAT on supplies, can reclaim input VAT;
- Exempt – cannot charge VAT nor reclaim input VAT;
- Outside the scope – taxation not in the Hungarian VAT system;
- Domestic Reverse Charge – VAT is charged and reclaimed by customer.

The supply of most types of goods and services in Hungary would be classified as Taxable supplies. However when these supplies are made to companies which are outside of Hungary advice needs to be sought as to what rate of VAT, if any, to apply.

If a Hungarian entity sells goods, which later on leave territory of Hungary or provides services to its non EU parent then there is no VAT chargeable on this overseas supply, however on the basis that the supply would be VAT'able if made in Hungary then the entity will be able to

reclaim all its input VAT.

Two lower rates are defined by the law at 5% (medicine, healthcare equipment, books, periodicals, district heating, some basic food: beef, veal, sheep, pig meat, poultry, eggs, fresh milk, etc.) and 18% (some type of food: dairy and cereal products, accomodation, meals in restaurants, internet subscription).

Can we provide Share option plans to our staff?

Many companies see Share Option plans as being an important way of attracting, motivating and retaining key staff.

Hungary has a number of "approved" share option plans which give tax benefits to employees and employers alike and it is often possible to adapt an overseas stock option plan to fit into one of these "approved" plans.

However this is a very technically complex area and careful planning needs to be undertaken as soon as share option plans are being considered for implementation in Hungary.

How else can we compensate our employees?

Hungary has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Pensions, health funds, recreation card, gym card, private medical insurance, life and disability cover are now commonplace benefits provided by many Hungarian businesses to their workforce.

Flexible benefit packages are also gaining in popularity, giving employees options on how they wish to “spend” their benefits allowance.

To discuss your requirements please contact the International Office on +44 (0) 1245 449266 or email us directly.

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